No. 15909

In the United States Court of Appeals for the Ninth Circuit

W. A. RUSHLIGHT; RAYMOND G. RUSHLIGHT; W. A. RUSHLIGHT COMPANY, a partnership; W. A. RUSHLIGHT, Executor of the Estate of Betty Rushlight, deceased, APPELLANTS,

v.

UNITED STATES OF AMERICA, APPELLEE AND CROSS-APPELLANT

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF OREGON

BRIEF FOR THE UNITED STATES AS APPELLEE AND CROSS-APPELLANT

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STATEMENT OF JURISDICTION

This suit was filed against appellants by the United States in the United States District Court of Oregon under § 403(c)(2)(iv) of the Renegotiation Act of 1942 (56 Stat. 245, 982, 57 Stat. 348, 564; 50 U.S.C. App. 1191, *infra,* p. 31) "to recover * * * excessive profits" made by appellants during 1942 on certain Government war subcontracts.

The District Court, on December 5, 1957, granted summary judgment for the United States in the amount of $48,330.99 plus interest from September 5,

1956 (R. 67-71). Each party filed a timely notice of appeal (R. 71-72). The defendants below [1] appeal from the order granting the Government's motion for summary judgment. The Government cross-appeals from the holding limiting it to interest from September 5, 1956 rather than from the date of demand, January 8, 1946 (R. 78-80).

This Court has jurisdiction to review the judgment below under 28 U.S.C. 1291.

STATEMENT OF THE CASE

Appellants are partners in a partnership known as W. A. Rushlight Company, organized on March 12, 1942 with its principal place of business during the year 1942 in Portland, Oregon (R. 47). During the period March 27, 1942 to December 31, 1942, the appellants received or accrued $471,485 primarily from the performance of Government contracts or subcontracts for the installation of plumbing and heating equipment at Walla Walla Air Base, Washington (R. 48, 52, 53). These sales were subject to renegotiation under the Renegotiation Act of 1942. 56 Stat. 245, 982; 57 Stat. 348, 564. (R. 52).

From these sales, appellants realized profits, before renegotiation, amounting to $137,392, or 29.2% of sales (R. 37). In accordance with the provisions of the Renegotiation Act, the War Department Price Adjustment Board, on December 18, 1945, unilaterally determined that appellants had realized excessive profits in the amount of $80,000 from its renegotiable contracts

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[1] By stipulation, the parties have agreed that in this proceeding in this Court defendants below shall be designated as "appellants" and that plaintiff below shall be designated as "appellee" and "cross-appellant".

during the period March 27, 1942 to December 31, 1942 (R. 6-10). On the same date, appellants were notified of the determination of $80,000 by the Chairman of the War Department Price Adjustment Board (R. 11) who, at the same time, formally demanded payment of the principal amount of the renegotiation debt. The demand letter further advised appellants that, if payment, less an applicable tax credit, were not made before January 8, 1946, interest would accrue on the indebtedness at the rate of 6% per annum from and after that date (R. 10-11). To this date, appellants have not voluntarily paid any part of the debt. However, the sum of $7,815.03 was withheld in 1954 from monies otherwise due the estate of one of the partners and was applied to a reduction of accrued interest (R. 31, 34).

Within the ninety days after the Board's determination and pursuant to § 403(e)(2) of the Renegotiation Act of 1943 (58 Stat. 78; 50 U.S.C. App. 1191, *infra*, p. 33), appellants filed a petition in the Tax Court of the United States seeking a redetermination of their excessive profits for March 27, 1942 to December 31, 1942 (R. 30). After a trial on the merits, the Tax Court, on September 5, 1956, entered an order, based on detailed findings of fact and an opinion, redetermining appellants excessive profits in the amount of $66,700 (R. 32, 46-55). Appellants filed a petition to review the Tax Court's decision in the Court of Appeals for the District of Columbia Circuit but, on December 17, 1956, sought and obtained dismissal of their petition before the case was docketed (R. 57).

In the meanwhile, the Government, on November 26, 1946, and as authorized by § 403(c) of the 1942

Renegotiation Act, filed a complaint in the District Court of the United States for the District of Oregon seeking to recover the unpaid 1942 excessive profits of $80,000 less applicable tax credit (R. 3-12).[2] Following the September 5, 1956 Tax Court decision, the Government filed a third amended complaint asking for judgment in the amount of $66,700 (the Tax Court's redetermined amount of excessive profits) less tax credit of $10,553.98, making the debt sued for $56,146.02 plus interest at the rate of 4¼% per annum from January 8, 1946 to the date of judgment less $7,815.03 applied to accrued interest as of April 20, 1954, plus costs (R. 28-32).

In their answer, appellants admitted the Tax Court determination of $66,700 and that the tax credit applicable to such $66,700 was $10,553.98, thus eliminating any issue as to the amount of the principal debt. (R. 33). However, appellants' answer further alleged, as a second defense, that they had losses from renegotiable sales for the years 1944 and 1945 and that the Tax Court had refused to give consideration to the 1944 and 1945 losses (R. 34-37). Appellants alleged that they, accordingly, had no 1942 excessive profits

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[2] An amended complaint was filed on June 6, 1949, asserting that appellants were entitled to a tax credit under the Internal Revenue Code of 1939 in the amount of $42,013, leaving a net principal debt due the United States of $37,987. The Government prayed judgment for such sum plus interest at the rate of 6% per annum from January 8, 1946 (R. 15-19). On April 12, 1955, the Government filed a second amended complaint alleging that the proper tax credit under the Code was $17,136.29, leaving a revised net principal amount due of $62,863.71. The Government prayed for judgment in that amount plus interest at the rate of 4¼% per annum from January 8, 1946 to and including the date of payment less the sum of $7,815.03 applied to accrued interest in 1954, plus costs (R. 24-27).

and prayed the Government's complaint be dismissed (R. 33-37).

In addition, appellants filed Requests for Admissions in the District Court, asking the Government to admit (1) that in the Tax Court proceeding, appellants had offered in evidence a schedule (R. 37) designed to show their losses for the years 1944 and 1945 (R. 39-41), and (2) that the Tax Court had sustained the Government's objections to the admission in evidence of profits and losses for years subsequent to 1942 on the ground that such material was irrelevant and incompetent (R. 41).[3]

On April 2, 1957, the Government filed objections to appellants' requests for admissions and filed a motion to strike appellee's second defense (R. 42-44). On the same day, the Government moved for summary judgment, asserting, among other things, that the District Court did not have jurisdiction to review or redetermine matters decided by the Tax Court, that the decision of the Tax Court was *res judicata,* that there was no dispute or question of fact relating to the amount of the debt flowing from the determination of excessive profits which had been finally and conclusively determined for 1942 by the Tax Court (R. 44-45).

On December 5, 1957, the District Court, after concluding that it lacked jurisdiction to consider matters raised in the Tax Court and that the Tax Court's determination of the amount of the principal debt

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[3] In the Tax Court, the Government successfully argued (R. 41) that appellants were attempting to circumvent the Renegotiation Act's statutory prohibition against "carry-over or carry-back [of losses] under any circumstances" by trying to offset 1944 and 1945 losses against 1942 excessive profits. 50 U.S.C. App. 1191. *Infra,* p. 30.

sought was *res judicata* and binding on the District Court, (1) granted the Government's motion to strike the second defense, (2) sustained the Government's objections to appellants' requests for admissions, and (3) awarded the Government summary judgment against appellants in the sum of $48,330.99 plus interest at the rate of 4¼% per annum from and after September 5, 1956 (R. 65, 66, 67, 68, 70, 71).[4]

SPECIFICATION OF ERROR ON CROSS-APPEAL

The Government, on its cross-appeal, contends that the District Court erred in awarding the Government interest from September 5, 1956 in lieu of awarding it interest from January 8, 1946.[5] (R. 79, 80)

SUMMARY OF ARGUMENT

I. This is an appeal from a summary judgment in which the United States recovered a renegotiation debt. The amount of the debt was finally determined by the Tax Court, in the exercise of its exclusive jurisdiction, and the Tax Court's determination of the principal amount of a renegotiation debt is by statute conclusive

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[4] The District Court reduced the prinicipal of $56,146.02 sought in the Government's complaint to $48,330.99 because, in denying the Government interest before September 5, 1956, he applied the $7,815.03 withheld in 1954 to principal rather than to accrued interest.

[5] If, as we believe, the judge erred in limiting the Government to interest from September 5, 1956, rather than from January 8, 1946, then it follows that the Court below should be directed to enter judgment in the principal amount of $56,146.02 (plus interest from January 8, 1946) rather than in the amount of $48,330.99. The judge's entry of judgment for the latter amount is due to his failure to award interest from 1946 and to his application of the 1954 withholding, amounting to $7,815.03, to reduction of the principal rather than to reduction of interest properly accruing since 1946.

and not reviewable. *United States* v. *California Eastern Line, Inc.,* 348 U.S. 351; *Bass* v. *United States,* 221 F. 2d 494 (C.A. 8), cert. den. 350 U.S. 827.

The Tax Court's determination of the principal amount of the debt is *res judicata* and for that additional reason may not be challenged or disturbed in the present collection proceeding. *Bass* v. *United States, supra; Ring Construction Corp.* v. *United States,* 102 F. Supp. 569 (C. Cls.), cert. den., 343 U.S. 953; *United States* v. *Ring Construction Corp.,* 178 F. 2d 714, cert. denied, 339 U.S. 943.

Under similar circumstances and whether or not a contractor has filed a petition in the Tax Court, courts in the Ninth Circuit have consistently granted the Government's motions for summary judgment. *Sampson Motors, Inc.* v. *United States,* 168 F. 2d 878; *United States* v. *Pownall,* 65 F. Supp. 147, aff'd., 159 F. 2d 73, aff'd., 334 U.S. 742; *United States* v. *Bonnell,* 180 F. 2d 145; *United States* v. *Clark,* 72 F. Supp. 393 (Ore.).

Realizing that they have no legal defense to this case, appellants seek to avoid payment of their debt by endeavoring to assert the doctrine of equitable recoupment. The doctrine has occasionally found support in tax cases. *Bull* v. *United States,* 295 U.S. 247; *Stone* v. *White,* 301 U.S. 532. In recent years, however, the area in which the doctrine is applied has been consistently narrowed. *McEachern* v. *Rose,* 302 U.S. 56; *Rothensies* v. *Electric Storage Battery Co.,* 329 U.S. 296. Indeed, this Court has already ruled that the Supreme Court has so narrowed the doctrine in tax cases as to virtually extinguish it. *Wells Fargo Bank & Union Trust Co.* v. *United States,* 245 F. 2d 524.

Even if the doctrine might appear to be applicable here, appellants fail to meet the tests of application. The basis for their assertion of equitable recoupment is that the 1942 renegotiation debt should be forgiven because of losses incurred by appellants in 1944 and 1945. But the explicit terms of the Renegotiation Act unequivocally prohibit such a carry-back of losses in determining excessive profits. Section 403(a)(4)(C), *infra,* p. 30. In addition, these losses arose out of the operation of a steel works by appellants and in no way were connected with the plumbing and heating contracts from which excessive profits were realized in 1942. Unless the losses arise out of the same transaction or circumstances, the doctrine of equitable recoupment cannot be asserted. *Bull* v. *United States, supra; Stone* v. *White, supra.*

II. As cross-appellant, the Government asserts that the District Court erred in failing to award interest for the ten years from the date of demand in 1946 until the redetermination of appellants' excessive profits by the Tax Court in 1956. It is true that the award of interest and the rate of interest are discretionary. *United States* v. *Bonnell, supra; United States* v. *United Drill & Tool Corp.,* 183 F.2d 998 (C.A.D.C.); *United States* v. *Edward Valves, Inc.,* 207 F.2d 329 (C.A. 7), cert. den., 347 U.S. 934. Nevertheless, the Government believes that to reward a contractor who has flouted a Congressional mandate to pay its renegotiation debt [6] by forgiving ten years of interest con-

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[6] Under § 403(e)(2) of the Renegotiation Act, Congress has provided that the filing of a petition in the Tax Court shall not operate to stay the duty to pay a renegotiation debt or the Government's suit in the District Court to recover the debt. 50 U.S.C. App. 1191.

stitutes plain abuse of discretion by the District Court. The duty to pay this public debt at all times existed. Regardless of whether the Tax Court, as here, reduced the excessive profits or whether, as here, there were years of dispute as to tax credit between the appellants and the Commissioner of Internal Revenue, it was impossible for appellants to be prejudiced by any overpayment of taxes or renegotiation liabilities because adequate machinery for repayment of such overpayments together with interest had been established by Congress. 50 U.S.C. App. 1231(f); *Stow Mfg. Co.* v. *Commissioner,* 190 F.2d 723 (C.A. 2), cert. denied, 342 U.S. 904; *United States* v. *Failla,* 219 F.2d 212 (C.A. 3); *Jackson* v. *United States,* 242 F.2d 333 (C.A. 6).

ARGUMENT

I

The District Court Was Plainly Correct in Refusing to Reduce the Amount of the Renegotiation Debt Finally Determined by the Tax Court and in Refusing to Consider 1944-1945 Losses.

A. *Appellants Have No Defense to This Suit to Recover a Simple Debt.*

As the pleadings below show, this suit involves nothing more than an action by the United States to recover a simple debt. In its third amended complaint, the United States pleaded the determination of excessive profits by the War Department Price Adjustment Board acting under due authority, the redetermination of excessive profits by the Tax Court in the amount of $66,700, and the reduction of the principal debt of $66,700 by a tax credit under § 3806 of the Internal Revenue Code of 1939 in the amount of $10,553.98 (R.

28-31). These allegations are admitted in appellants' answer to the third amended complaint (R. 33). Thus, there is no dispute between the parties of whether or not the debt exists. Hence, appellants, who have refused to pay their renegotiation debt for approximately thirteen years, now have seized on allegedly "equitable" reasons in justification of their refusal to pay.

That the sole function of the Government's suit below is to recover a debt is conclusively established by the circumstances under which the amount of a renegotiation debt is determined.[7] Congress, after having provided authority for administrative unilateral determination of amounts of excessive profits by the renegotiators, provided that a dissatisfied contractor could petition the Tax Court for a redetermination of the amount of its excessive profits. With respect to fiscal years ending before July 1, 1943, Congress specifically provided, in § 403(e)(2) of the 1943 Act (50 U.S.C. App. 1191):

> Any contractor or subcontractor * * * aggrieved by a determination of the Secretary * * * with respect to a fiscal year ending before July 1, 1943, as to the existence of excessive profits, * * * may * * * file a petition with the Tax Court of

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[7] The Court of Appeals for the District of Columbia Circuit has said that "sums due the United States upon renegotiation are clearly debts. The contractor owes the United States because the United States has overpaid him." *United States* v. *United Drill & Tool Corp.*, 183 F.2d 998, 1000 (C.A.D.C.). The Tax Court and the Court of Claims agree. *Larrabee* v. *Stimson*, 17 T.C. 69, 76; *Putnam Tool Company* v. *United States*, 147 F. Supp. 746 (C. Cls.), cert. den., 355 U.S. 825.

> the United States for a redetermination thereof * * *.

In § 403(e)(2), Congress further provided that a Tax Court proceeding involving fiscal years ended before July 1, 1943 (the period here) would be subject to the same provisions as in the case of a Tax Court redetermination for fiscal years ending after July 1, 1943. With respect to this latter period, Congress provided in § 403(e)(1) of the Renegotiation Act, insofar as a Tax Court proceeding was concerned, that:

> * * * Upon such filing such court shall have *exclusive jurisdiction, by order, to finally determine the amount, if any, of such excessive profits* received or accrued by the contractor or subcontractor, and such determination shall not be reviewed or redetermined by any court or agency. The court may determine as the amount of excessive profits an amount either less than, equal to, or greater than that determined by the Board. * * * [Emphasis added].[8]

This unambiguous statutory language makes it perfectly "clear", as observed by the Court below, "that the Tax Court's determination of the amount of the

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[8] Recognizing that contractors who have filed petitions in the Tax Court might consider the filing of a petition a reason for not paying their renegotiation debts during the pendency of the Tax Court proceeding, Congress, in addition to specifically providing for the filing of suits in courts of the United States to recover the indebtedness, provided that the "filing of a petition [in the Tax Court] under this subsection shall not operate to stay the execution of the order of the Board under subsection (c)(2)." It is subsection (c)(2) which authorizes actions "on behalf of the United States * * * in the appropriate courts of the United States" (50 U.S.C. App. 1191).

principal debt is res judicata and binding upon this Court." (R. 63).[9]

The Court of Appeals for the Eighth Circuit, in a case on all fours with the present one, summarized the settled law (*Bass* v. *United States,* 221 F. 2d 494, 496-7, cert. den., 350 U.S. 827):

> We think the District Court could not, under the circumstances, logically have done otherwise than grant the motion of the United States for a summary judgment. As the District Court ruled, the decision of the Tax Court in the redetermination proceeding initiated by the defendants in that court, which proceeding was between the same parties with respect to the same claim, was res judicata not only as to all questions presented to the Tax Court but as to all questions which could have been presented to that court. Tait v. Western Maryland R. Co., 289 U.S. 620, 623, 53 S. Ct. 706, 77 L.Ed. 1405; Guettel v. United States, 8 Cir., 95 F. 2d 229, 230-231, 118 A.L.R. 1060;

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[9] The District Court's statement that the Tax Court's determination of the principal amount of the debt is *res judicata* and binding on the Court is a clear statement of the law as reflected in numerous decisions on both renegotiation matters and tax questions. See *Bass* v. *United States,* 221 F.2d 494 (C.A. 8), cert. den., 350 U.S. 827; *Ring Construction Corp.* v. *United States,* 178 F.2d 714 (C.A. 8), cert. denied, 339 U.S. 943; *Ring Construction Corp.* v. *United States,* 102 F. Supp. 569 (C. Cls.), cert. den., 343 U.S. 953; *International Building Co.* v. *United States,* 199 F.2d 12 (C.A. 8), rev'd. on other grounds, 345 U.S. 502; *Continental Petroleum Co.* v. *United States,* 87 F.2d 91 (C.A. 10), cert. den., 300 U.S. 679; *Rubel Co.* v. *Rasquin,* 43 F. Supp. 111, aff'd., 132 F.2d 640 (C.A. 2); *United States* v. *Maguire,* 42 F. Supp. 337 (N.J.); *Monjar* v. *Higgins,* 39 F. Supp. 663, aff'd., 132 F.2d 990 (C.A. 2); *Pelham Hall Co.* v. *Carney,* 27 F. Supp. 388, aff'd., 111 F.2d 944 (C.A. 1); *Pelham Hall Co.* v. *Hassett,* 147 F.2d 63 (C.A. 1).

Pelham Hall Co. v. Hassett, 1 Cir., 147 F. 2d 63, 66-67 and cases cited; International Building Co. v. United States, 8 Cir., 199 F. 2d 12, 18, reversed on other grounds 345 U.S. 502, 73 S. Ct. 807, 97 L. Ed. 1182.

The Tax Court alone had jurisdiction to redetermine the amount of excessive profits realized by the defendants. United States v. California Eastern Line, Inc., supra. Any questions as to jurisdiction of the Under Secretary of War to determine excessive profits or of the Tax Court to decide the issues presented to it and any questions as to the constitutionality of the Renegotiation Act or the proceedings taken under it were subject to review under 26 U.S.C. § 1141. United States v. California Eastern Line, Inc., supra. Since we are convinced that the decision of the Tax Court could not be reviewed, re-opened or collaterally attacked in the District Court and was res judicata as to the validity and amount of the Government's claim, there is no justification for stating the various contentions of the defendants relating to the alleged invalidity of the claim.

In addition, the decision below, granting summary judgment to the United States, is entirely consistent with numerous holdings by this Court, affirming other decisions of the district courts which have without exception granted summary judgment to the United States for the full amount of the principal renegotiation debt. For example, see *Sampson Motors, Inc.* v. *United States,* 168 F. 2d 878; *United States* v. *Pownall,* 65 F. Supp. 147, aff'd., 159 F. 2d 73, aff'd., 334

U.S. 742; *United States* v. *Bonnell,* 180 F. 2d 145. See also, *United States* v. *Clark,* 72 F. Supp. 393 (Ore.), where the Court cogently and accurately described the renegotiation collection process:

> The * * * Board makes a unilateral determination of the amount due as excessive profits and demands immediate payment. This is followed by suit in the District Court, *to which the contractor may not make a defense. He may not defend, because the Tax Court has been given exclusive jurisdiction to try his case de novo. The Tax Court's decision is final and not reviewable. Going into the Tax Court does not stay the case in the District Court. The case passes to judgment summarily.* (p. 394) [Emphasis added].

The foregoing authorities, we submit, conclusively establish that the Court below correctly decided that appellants have no legal defense to this action to recover a simple debt. Accordingly, it is not surprising that appellants, in this Court assert no legal defense to the Government's suit and endeavor, instead, to evolve an equitable defense. Thus, appellants here seek to avoid payment of their debts by resort to the doctrine of equitable recoupment. But, as we show below—even if it is assumed *arguendo* that it may be permissible to invoke the doctrine notwithstanding the finality of the Tax Court determination—the doctrine of equitable recoupment is rarely applied and, in fact, has never been applied to forgive a debt, where, as here, there is no fixed or specific claim against the creditor.

B. *The Doctrine of Equitable Recoupment Cannot be Employed to Forgive the Renegotiation Debt Due the United States Here.*

At the outset, it must be noted that appellants assert no specific claim against the United States which should be set off against their renegotiation debt. Appellants nevertheless urge that the renegotiation debt finally and conclusively determined to be due the United States by the Tax Court should be forgiven under the doctrine of equitable recoupment. Appellants primarily rely on two tax cases, *Bull* v. *United States,* 295 U.S. 247, and *Stone* v. *White,* 301 U.S. 532, and on such cases as *Clinkenbeard* v. *United States,* 88 U.S. 65, 21 Wall. 65. But, in all of these cases, when the doctrine of equitable recoupment has been applied, the defendant had a specific claim against the plaintiff arising out of the same facts giving rise to plaintiff's suit which, while valid, was unenforceable. For example, in *Bull* v. *United States,* a taxpayer had overpaid his taxes, and his cause of action to recover the overpayment was barred by the statute of limitations, i.e., the claim existed but his remedy was barred. The Supreme Court permitted the Court of Claims to apply the doctrine of equitable recoupment when the Government sued to recover a deficiency for another taxable year arising out of the same transaction from which the taxpayer had overpaid his taxes. The Supreme Court applied the doctrine, noting that "recoupment is in the nature of a defense arising out of some feature of the action on which plaintiff's action is grounded."

In the more recent cases, however, the Supreme Court and numerous courts of appeals, including this

Court, apparently concerned with the implications of a comparatively broad application of the doctrine of equitable recoupment as stated in *Bull* v. *United States* and *Stone* v. *White,* have consistently narrowed the application of the doctrine. See *McEachern* v. *Rose,* 302 U.S. 56; *Rothensies* v. *Electric Storage Battery Co.,* 329 U.S. 296. Thus, this Court, in *Wells Fargo Bank & Union Trust Co.* v. *United States,* 245 F. 2d 524 (1957), recently made it clear that it fully shares the current view that the *Bull* and *Stone* cases have been so narrowed as to have virtually no value as precedents. In its *Wells Fargo* opinion, this Court said, at p. 535:

> Suffice to say that the so-called equitable doctrine of estoppel and equitable recoupment is based primarily upon the two Supreme Court cases, Bull v. United States, 1935, 295 U.S. 247, 55 S. Ct. 695, 79 L. Ed. 1421 and Stone v. White, 1927, 301 U.S. 532, 57 S. Ct. 851, 81 L.Ed. 1265. Further, that this equitable doctrine is predicated upon the peculiar equity involved in the respective cases. In subsequent decisions the Supreme Court and lower Court restricts the doctrine to the factual situation of those cases, and narrowed the effect thereof to the point that led Judge Frank, of the Second Circuit, to say:
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> "The gap in statutes of limitation created by the recoupment doctrine in tax cases seemed at one time to be fairly wide. But the gap has been narrowed markedly by McEachern v. Rose, 302 U.S. 56, 58 S. Ct. 84, 82 L.Ed. 46, and Rothensies v. Electric Storage Battery Co., 329 U.S. 296, 67 S. Ct. 271, 91 L.Ed. 296. Frankly, we do not know just how much of that doctrine still lives * * *."

Wood v. United States, 2 Cir., 1954, 213 F. 2d 660, 661, affirming, D.C.S.D.N.Y., 1953, 121 F. Supp. 764. [Footnote omitted].

In any event, it cannot be challenged that the doctrine of equitable recoupment, when asserted as a defense, must arise "out of some feature of the transaction upon which the plaintiff's action is grounded." *Bull* v. *United States, supra.* Wholly apart from the effect of recent cases, the doctrine of equitable recoupment never permitted "one transaction to be offset against another, but only * * * permit[ted] a transaction which is made the subject of suit by a plaintiff to be examined in all its aspects * * * ". *Rothensies* v. *Electric Storage Battery Co.,* 329 U.S. 296, 299.

The record here plainly shows that the alleged claim which appellants seek to have offset against the renegotiation debt admittedly owed to the Government has no relation to the transactions giving rise to this debt.

The debt here arose as a result of the renegotiation of appellants' 1942 contracts, and the determination of excessive profits covered the fiscal period March 27, 1942 to December 31, 1942 (R. 29, 33). The 1942 contract gross earnings resulting in the determination of excessive profits for the period March 27, 1942 to December 31, 1942 totalled $486,987 (R. 7, 8). All of these contracts were completed by appellants on or before December 31, 1942 (R. 7, 8). The record sets these contracts out in detail (R. 7, 48). More than 80% of the renegotiated 1942 income was derived from appellants' performance as a subcontractor installing plumbing and heating equipment at an air base at Walla Walla, Washington (R. 8, 48). For the doctrine of equitable recoupment to have any possible applica-

tion, it would be necessary for appellants to establish that the claim, which they would offset against the debt, arose in some way out of their performance of 1942 plumbing and heating contracts from which they realized excessive profits.

Appellants do not even attempt to show that their alleged claim arose out of the 1942 contracts in question. Instead, they seem to rely on losses incurred by them on other contracts in the years 1944 and 1945. But the Tax Court, which had sole jurisdiction to determine the amount of the 1942 renegotiation debt,[10] as the trial court properly pointed out, refused to admit evidence pertaining to these losses because such evidence was "immaterial and incompetent" (R. 41), i.e., could not be used to reduce the debt. The statute, as already noted, expressly prohibits the use of such losses to reduce the debt, *supra,* p. 8. Moreover, appellants' losses in 1944 and 1945 were actually derived almost entirely from its operation in those years of a "Steel Works Division" of their partnership (R. 37). The steel works apparently was entirely unsuccessful since it operated at losses exceeding $250,000 during 1943, 1944, and 1945 and was abandoned by appellants. (R. 37) In the course of abandoning the steel works, appellants incurred further losses of more than $75,000 during 1943 and 1945 (R. 37).

Thus, the record shows that the post-1942 steel works losses were not even remotely related to the performance of the plumbing and heating subcontracts com-

[10] In the exercise of its exclusive jurisdiction, the Tax Court did in fact reduce the principal renegotiation debt from $80,000 to $66,700 because the Court felt that appellants were entitled to a salary allowance whereas the renegotiators had made no allowance. In the Tax Court, the Government conceded that a salary allowance was proper. (R. 55).

pleted in 1942 and from which the excessive profits in question were realized. Indeed, appellants do not make any claim that the steel works losses were derived from or in any way were connected with the contracts from which excessive profits were realized. Consequently, even in its present narrow application under the more recent cases, the facts here entirely preclude the application of the doctrine of equitable recoupment to this case.

As shown above, appellants have and assert no legal defense to the Government's action to recover the renegotiation debt. In addition, appellants' so-called equitable defense is equally lacking in merit. It is submitted that this Court should therefore affirm the decision below, granting summary judgment to the Government, with respect to appellants' liability for the debt.

C. *Appellants' Arguments are Without Merit*

Appellants argue (App. Br., pp. 9, 10) that to allow the Government to recover this admitted debt is "unjust, oppressive and inequitable" because in years subsequent to the renegotiated 1942 year, appellants' partnership sustained a loss on its war contracts and from sales for all of the World War II years made a total profit of only approximately $8,700. As shown above, the losses in 1944 and 1945 were almost entirely due to operating losses in appellants' abortive effort to establish a steel works in Portland and in losses resulting from the sale and abandonment of the steel works.

These steel works losses may have been due to inept management, improper financing, or any number of

other possible causes. If the losses were incurred without fault or negligence on the part of appellants, relief presumably could have been sought in accordance with the procedure set up by Congress under the War Contracts Hardship Claims Act (Lucas Act), 60 Stat. 902, 62 Stat. 992. If the losses were due to the termination of Government contracts, relief could have been sought pursuant to the provisions of 41 U.S.C. 107. If the losses occurred because of errors in contract negotiations, delay due to slow priorities, or allocations, or for similar reasons, relief could have been applied for under the First War Powers Act, 50 U.S.C. 61, and the various Executive Orders issued thereunder. The record below is silent as to whether appellants invoked any of these avenues of relief. Certainly, their failure to do so should not be allowed to work a forfeiture of the renegotiation debt admittedly due the Government.

Appellants further complain that the court below erred in striking appellants' second defense which was designed to plead the facts pertaining to the Tax Court's exclusion from evidence of statements intended to show the losses incurred in 1944 and 1945. The trial court held that the subject matters of the second defense were "matters of law which were fully determined by the Tax Court's determination [of the amount of the debt] and that this Court does not have jurisdiction of the matters so raised * * *." (R. 66).

Appellants apparently now believe that the Tax Court correctly excluded from evidence facts with respect to post-1942 losses which appellants had strenuously insisted the Tax Court should admit during the trial (App. Br., pp. 17-20). Appellants correctly state

that the Tax Court excluded the evidence because of the provision in the Renegotiation Act prohibiting the Tax Court from applying carry-overs or carry-backs of losses in determining excessive profits (App. Br., p. 18). See Section 403(a)(4)(C), *infra,* p. 30. With this, of course, the Government is in agreement with the Tax Court.[11] Here, contrary to their Tax Court position where they insisted the Tax Court could consider the question, appellants assert that what they were really attempting to present to the Tax Court was the doctrine of equitable recoupment. They then argue that since, under the decision of the Supreme Court in *Commissioner* v. *Gooch Milling & Elevator Co.,* 320 U.S. 418, the Tax Court has no equitable jurisdiction, it could not and did not pass on the so-called equitable defense. From this, appellants argue that the court below should have considered the equitable defense.

Appellants confuse the issue. The Tax Court was *not* refusing to exercise equitable jurisdiction when it rejected the evidence of losses in later years. Neither was the court below. The Tax Court was merely following a Congressional mandate to not allow as

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[11] Appellants' arguments shift with the wind. Appellants now say that the Tax Court correctly excluded evidence relating to losses in post-1942 years, that the losses may now somehow be used as an offset to reduce their admitted renegotiation debt. On the other hand, in the Tax Court, appellants insisted that the post-1942 losses were an *element* in determining 1942 excessive profits, i.e., the renegotiation debt. In his Tax Court reply brief, present counsel for the appellants stated:

> The position of the petitioner was and as stated by its counsel in the opening statement and in the petition, namely, losses in other war years are a factor to be considered in determining whether the petitioner had an excess profit. [T.C. Reply Br., p. 3].

items of cost in 1942 determinations of excessive profits amounts representing carry-backs of losses from subsequent years even though such carry-backs may have been permissible for income tax purposes. Section 403(a)(4)(C), *infra,* p. 30. The court below, in recognizing that the Tax Court has exclusive jurisdiction to determine the amount of excessive profits, properly pointed out that the District Court does not have jurisdiction to reduce the principal debt by offsetting post-1942 losses because "the law is clear that the Tax Court's determination of the amount of the principal debt is res judicata and binding on this Court." (R. 63). The rejection by the court below of appellants' "equitable" basis for forgiving the debt was thus plainly correct.

In substance, what appellants seek is a forfeiture of the 1942 debt by "equitably" carrying back 1944-1945 losses—i.e., *they seek to do by indirection something which Congress has expressly prohibited the Tax Court, in the exercise of its exclusive jurisdiction, from doing directly.* Surely, appellants' efforts to circumvent the statute cannot acquire the dignity of a valid defense merely by the gratuitous designation of a pleading as a "defense of equitable recoupment."

II

The District Court Erred in Failing to Award the United States Interest from the Date of Initial Demand for Payment in 1946.

Attached to the third amended complaint as Exhibit B is a copy of the War Department Price Adjustment Board's notice dated December 18, 1945 to appellants advising them of the determination of excessive profits of $80,000 for fiscal 1942 and demanding payment of

that amount less applicable tax credit by January 8, 1946. The notice also advised appellants that interest would accrue at the rate of 6% per annum from and after January 8, 1946 on any amount of the renegotiation debt unpaid as of that date (R. 10, 11, 29, 30, 31). In their answer to the third amended complaint, appellants admitted the demand and advice to them that interest would accrue after January 8, 1946 (R. 33).

The court below, relying on *United States* v. *Star Construction Co., Inc.,* 186 F. 2d 666 (C.A. 10), ruled that the judgment herein should bear interest at the rate of 4¼% from September 5, 1956, the date upon which the Tax Court redetermined excessive profits in the amount of $66,700, rather than 4¼% from January 8, 1946, the date of demand for payment of the 1942 renegotiation indebtedness.[12]

It is true that the award of interest under the Renegotiation Act is a matter of judicial discretion. See *United States* v. *Bonnell, supra* (C.A. 9); *United States* v. *United Drill & Tool Corp., supra* (C.A.D.C.); *United States* v. *Edward Valves, Inc.,* 207 F.2d 329 (C.A. 7), cert. den., 347 U.S. 934; *Ring Construction Corp.* v. *United States,* 209 F.2d 668 (C.A. 8). It is our

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[12] The Renegotiation Act is silent on the question of interest. Hence, various district courts have awarded interest at various rates in an exercise of judicial discretion. In previous cases in Ninth Circuit district courts, the Government has been awarded interest at the rate of 6%. In *Sampson Motors, Inc.* v. *United States,* 168 F.2d 878, and *United States* v. *Pownall,* 159 F.2d 73, aff'd., 334 U.S. 742, for example, the Ninth Circuit affirmed the District Court's award of 6% interest from the date of demand for payment. However, in recent cases in the District Court in Oregon, interest in renegotiation collection suits was awarded at the rate of 4¼%. Hence, in its amended complaints herein, the Government prayed for interest at 4¼%, the rate awarded by the court below.

position, however, that the court below abused his discretion in denying the Government approximately ten years of interest.

This abuse of discretion is, we submit, attributable to the failure of the court below to give proper weight to the facts (1) that appellants have had and continue to have uninterrupted use of public funds since January 8, 1946 and (2) have deliberately avoided a Congressional order to pay a public debt when, at all times, they were assured of the recovery (with interest) of any overpayments which may have been made, either because of erroneous tax credit computation or Tax Court redetermination of a reduced principal debt. See 50 U.S.C. App. 1231(f).

As we have already noted, the decision below, in refusing to award interest from 1946, relies heavily on *United States* v. *Star Construction Company, supra.* But the *Star Construction Company* case is easily distinguished on the ground that there the United States failed to allege and prove that any demand for the payment of the debt was made prior to the filing of the complaint. Here, the record is clear that demand for payment was made on December 18, 1945 (R. 11). Moreover, the rationale of the *Star Construction Company* decision—i.e., that where the amount of tax credit was in dispute and was determined at the time of trial, the United States was not entitled to interest prior to judgment because the sum was indefinite, unliquidated, and disputed—has been rejected by other courts considering the interest question. Thus, in *Stow Mfg. Co.* v. *Commissioner,* 190 F.2d 723 (C.A. 2), cert. den., 342 U.S. 904, Judge Learned Hand pointed out that if there were errors in tax credit computations, they may

be corrected under the Internal Revenue Code and any overpayments or underpayments because of tax credit errors may be adjusted administratively or by subsequent litigation.[13] Again, in *United States* v. *Failla,* 219 F.2d 212 (C.A. 3), the contractor resisted summary judgment in a renegotiation collection case, because the alleged tax credit was too low and, the contractor argued, the debt was unliquidated. In affirming the award of summary judgment to the United States and the award of interest from the date of demand in spite of the tax credit dispute, the Third Circuit held that the fact that the tax credit was disputed and the debt theoretically unliquidated did not deprive the United States of the right to summary judgment and to interest from the date of demand. As in *Stow,* the Court pointed out that any alleged errors in tax credit computations may be corrected in the usual procedure under the Internal Revenue Code either by administrative proceedings or by litigation. The Sixth Circuit reached the same result in *Jackson* v. *United States,* 242 F.2d 333.

These cases show that the proper procedure for a renegotiated contractor who disputes the tax credit and thus claims the renegotiated debt is unliquidated is to pay the amount of excessive profits less the al-

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[13] Administrative adjustment is exactly what occurred in this case where the tax credit was variously computed and pleaded and settled during the period from 1949 to 1956 (R. 18, 20, 25, 30). Further, appellants resisted the Commissioner's computation of their taxes for 1942 and, hence, in part caused the indecision with respect to tax credit. This indecision continued until August 1, 1953, when appellants and representatives of Internal Revenue Service settled their dispute, making a final computation of tax credit then possible for the first time (R. 39, 40). These circumstances, far from justifying a forgiving of ten years' interest, emphasize the necessity for prompt payment of renegotiation debts.

lowed tax credit, then seek a refund from Internal Revenue Service based on the amount of additional tax credit the contractor contends should be allowed. As the above cases show, if Internal Revenue Service fails to act on the claim in six months, the Internal Revenue Code permits the contractor to sue to recover the balance of the claimed tax credit. Under these circumstances, in the *Failla* and *Jackson* cases, the courts of appeals upheld the district court's exercise of discretion in allowing interest on these renegotiation debts *from the date of demand* to the date of judgment.

In *United States* v. *Employers Mutual Casualty Company,* 226 F.2d 895, the Eighth Circuit held that the District Court had abused his discretion in failing to award the United States interest from the date of default when a surety had failed to respond to a valid demand for payment. The interest, the Eighth Circuit said, was "an appropriate measure of damage for the delay in payment" (p. 900). Not only did the Eighth Circuit rely on cases asserted here by the Government (p. 898) but the court specifically rejected a contention apparently relied on by the district court below in this case, that "the longer the lawsuit remained in court, the longer the surety was relieved from payment of interest." (p. 900).

In line with the foregoing decisions, this Court, in *Sampson Motors, Inc.* v. *United States,* 168 F.2d 878, 879, after quoting extensively from *United States* v. *Strontium Products Co.,* 68 F. Supp. 886, including statements from *Billings* v. *United States,* 232 U.S. 261, that the United States is entitled to interest from the date of demand, allowed 6% interest on a renegotiation debt *from the date of demand.* This Court

quoted the following pertinent language from the *Strontium Products Co.* case:

> Allowance of interest at a fair rate from the date of default on the principal sum [renegotiation debt] found to be due is an appropriate measure of damages. * * * The tenor of the Act clearly reveals a Congressional purpose to effect speedy collection. The provision authorizing review by the Tax Court is specifically limited so as to not operate "to stay the execution of the order of the Board". * * * *Such a statutory policy makes it essential to exact interest from the contractor who refuses to pay, and who retains the use of the money while depriving the Government of its use, so as not to penalize prompt contractors who comply with the letter and spirit of the Act.* [Emphasis added].

Similarly, in *United States* v. *United Drill & Tool Corp.*, 183 F. 2d 998, the Court of Appeals for the District of Columbia Circuit said that "sums due the United States upon renegotiation are clearly debts" and that the "contractor owes the United States because the United States has overpaid him." Interest, therefore, runs from the date upon which the contractor fails to make repayment, after proper notice.[14] Further, contrary to the holding below that interest

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[14] For other cases where district courts have awarded the United States interest on renegotiation debts from the date of demand, whether or not the contractor had filed a petition in the Tax Court, see *United States* v. *Union Concrete Pipe Co.*, 93 F. Supp. 650 (D.C. W.Va.); *United States* v. *Clark*, *supra* (D.C. Ore.); *United States* v. *Grob, Inc.*, 132 F. Supp. 493 (D.C. Wisc.); *Ring Construction Corp.* v. *United States*, 209 F.2d 668 (C.A. 8); *United States* v. *Philmac Mfg. Co.*, 192 F.2d 517 (C.A. 3).

runs only from the date of the Tax Court's 1956 decision, the fact that appellants filed a petition in the Tax Court seeking a redetermination of their excessive profits is no reason for depriving the Government of interest from the 1946 date of initial demand. As the Eighth Circuit said in ruling on an identical contention in *Bass* v. *United States,* 221 F. 2d 494, cert. den., 350 U.S. 827:

> The defendants' assertions that interest should have been allowed only from the date of the Tax Court's decision is, in our opinion, not tenable. It was on August 30, 1944, that the amount of excessive profits was determined by the Undersecretary of War. * * * The determination was made under the authority of law and, we think, was presumptively correct from its inception. * * * Under the circumstances, the liability of the defendants accrued as of August 30, 1944, and interest ran from that date. (p. 497)

We submit that the foregoing authorities call for a ruling here that the court below abused his discretion in failing to award the Government interest from the date of demand in 1946.[15]

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[15] As the record shows, a sum of $7,815.03 otherwise due to the estate of one of the partners was not paid to the estate by the Government but was withheld and applied to a reduction of accrued interest on April 20, 1954 (R. 31, 34, 70). One result of the failure of the court below to award the Government interest prior to September 5, 1956 is that the $7,815.03 has been applied to a reduction of principal as of April 20, 1954. Thus, even though the memorandum opinion below states that the Government is entitled to judgment in the principal amount of $56,146.02 (R. 65), the court ordered summary judgment in the principal amount of $48,330.99 ($56,146.02 less $7,815.03) (R. 70, 71). See footnotes 4, 5, *supra,* p. 6.

CONCLUSION

For the forgoing reasons, it is respectfully submitted that the judgment below (1) should be affirmed on the main appeal and (2) should be modified on the cross-appeal with instructions to the court below to enter judgment in the amount of $56,146.02 together with interest thereon at the rate of 4¼% per annum from January 8, 1946 less the sum of $7,815.03 applied to accrued interest as of April 20, 1954.

Respectfully submitted,

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July 1958.

APPENDIX

Excerpts from pertinent statutes

Renegotiation Act of 1943 (50 U.S.C. App. 1191) 403(a)(4)(C):

Notwithstanding any of the provisions of this section to the contrary, no amount shall be allowed as an item of cost (i) by reason of a recomputation of the amortization deduction pursuant to section 124 (d) of the Internal Revenue Code until after such recomputation has been made in connection with a determination of the taxes imposed by Chapters 1, 2A, 2B, 2D, and 2E of the Internal Revenue Code for the fiscal year to which the excessive profits determined by the renegotiation are attributable or (ii) *by reason of the application of a carry-over or carry-back under any circumstances.* The absence of such a recomputation of the amortization deductions referred to in clause (i) above shall not constitute a cause for postponing the making of an agreement, or the entry of an order, determining the amount of excessive profits, or for staying the elimination thereof. [Emphasis added.]

* * * * *

402(c)(2):

Upon the making of an agreement, or the entry of an order, under paragraph (1) by the Board, or the entry of an order under subsection (e) by The Tax Court of the United States, determining excessive profits, the Board shall forthwith authorize and direct the Secretaries or any of them to eliminate such excessive profits (A) by reductions in the amounts other-

wise payable to the contractor under contracts with the Departments, or by other revision of their terms; or (B) *by withholding from amounts otherwise due to the contractor any amount of such excessive profits;* or (C) by directing a contractor to withhold for the account of the United States, from amounts otherwise due to a subcontractor, any amount of such excessive profits of such subcontractor; or (D) *by recovery from the contractor, through repayment, credit, or suit any amount of such excessive profits actually paid to him;* or (E) by any combination of these methods, as is deemed desirable. *Actions on behalf of the United States may be brought in the appropriate courts of the United States to recover from the contractor any amount of such excessive profits actually paid to him and not withheld or eliminated by some other method under this subsection.* The surety under a contract or subcontract shall not be liable for the repayment of any excessive profits thereon. Each contractor and subcontractor is hereby indemnified by the United States against all claims by any subcontractor on account of amounts withheld from such subcontractor pursuant to this paragraph. All money recovered in respect of amounts paid to the contractor from appropriations from the Treasury by way of repayment or suit under this subsection shall be covered into the Treasury as miscellaneous receipts. Upon the withholding of any amount of excessive profits or the crediting of any amount of excessive profits against amounts otherwise due a contractor, the Secretary shall certify the amount thereof to the Treasury and the appropriations of his Department shall be reduced by an amount equal to the amount so withheld or credited. The amount of such reductions shall be transferred to the surplus fund of the Treasury. In eliminating excessive profits the Secretary shall allow the contractor or subcon-

tractor credit for Federal income and excess profits taxes as provided in section 3806 of the Internal Revenue Code. For the purposes of this paragraph the term "contractor" includes a subcontractor. [Emphasis added.]

* * * * *

403(e)(1)

Any contractor or subcontractor aggrieved by an order of the Board determining the amount of excessive profits received or accrued by such contractor or subcontractor may, within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the last day) after the mailing of the notice of such order under subsection (c) (1), file a petition with The Tax Court of the United States for a redetermination thereof. *Upon such filing such court shall have exclusive jurisdiction, by order, to finally determine the amount, if any, of such excessive profits received or accrued by the contractor or subcontractor, and such determination shall not be reviewed or redetermined by any court or agency.* The court may determine as the amount of excessive profits an amount either less than, equal to, or greater than that determined by the Board. A proceeding before the Tax Court to finally determine the amount, if any, of excessive profits shall not be treated as a proceeding to review the determination of the Board, but shall be treated as a proceeding de novo. For the purposes of this subsection the court shall have the same powers and duties, insofar as applicable, in respect of the contractor, the subcontractor, the Board and the Secretary, and in respect of the attendance of witnesses and the production of papers, notice of hearings, hearings before divisions, review by the Tax Court of decisions of divisions, steno-

graphic reporting, and reports of proceedings, as such court has under sections 1110, 1111, 1113, 1114, 1115(a), 1116, 1117(a), 1118, 1120 and 1121 of the Internal Revenue Code in the case of a proceeding to redetermine a deficiency. In the case of any witness for the Board or Secretary, the fees and mileage, and the expenses of taking any deposition shall be paid out of appropriations of the Board or Department available for that purpose, and in the case of any other witnesses, shall be paid, subject to rules prescribed by the court, by the party at whose instance the witness appears or the deposition is taken. *The filing of a petition under this subsection shall not operate to stay the execution of the order of the Board under subsection (c) (2).* [Emphasis added.]

403(e)(2):

Any contractor or subcontractor (excluding a subcontractor described in subsection (a)(5)(B)) aggrieved by a determination of the Secretary made prior to the date of the enactment of the Revenue Act of 1943, with respect to a fiscal year ending before July 1, 1943, as to the existence of excessive profits, which is not embodied in an agreement with the contractor or subcontractor, may, within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the last day) after the date of the enactment of the Revenue Act of 1943, file a petition with The Tax Court of the United States for a redetermination thereof, and any such contractor or subcontractor aggrieved by a determination of the Secretary made on or after the date of the enactment of the Revenue Act of 1943, with respect to any such fiscal year, as to the existence of excessive profits, which is not embodied in an agreement with the contractor or subcontractor, may, within ninety days (not counting Sunday or a legal holiday

in the District of Columbia as the last day) after the date of such determination, file a petition with The Tax Court of the United States for a redetermination thereof. Upon such filing such court shall have the same jurisdiction, powers, and duties, and the proceeding shall be subject to the same provisions, as in the case of a petition filed with the court under paragraph (1), except that the amendments made to this section by the Revenue Act of 1943 which are not made applicable as of April 28, 1942, or to fiscal years ending before July 1, 1943, shall not apply.

* * * * *

Internal Revenue Code of 1939 (26 U.S.C. 1141):

Courts of review

(a) The courts of appeals shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 1254 of title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 1254 of title 28 of the United States Code.

(b) Venue

(1) In general. Except as provided in paragraph 2, such decisions may be reviewed by the court of appeals for the circuit in which is located the collector's office to which was made the return of the tax in respect of which the liability arises or, if no return was made, then by the United States Court of Appeals for the District of Columbia.

(2) By agreement. Notwithstanding the provisions of paragraph 1, such decisions may be reviewed by any court of appeals, or the United States Court of Appeals for the District of Columbia, which may be designated by the Commissioner and the taxpayer by stipulation in writing.

(3) Application of subsection. This subsection shall be applicable to all decisions of the Tax Court rendered on and after May 10, 1934, and section 1002 of the Revenue Act of 1926, 44 Stat. 110, as in force prior to May 10, 1934, shall be applicable to such decisions rendered prior thereto, except that paragraph 2 of this subsection may be applied to any such decision rendered prior to May 10, 1934.

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